

**THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA**

DOCKET NO. 2018-257-WS

IN RE: Application of Kiawah Island Utility,)	DIRECT TESTIMONY
Inc. for Adjustment of Rates and)	
Charges and Modifications to Certain)	OF
Terms and Conditions for the Provision)	
of Water and Sewer Service)	DONALD H. BURKETT

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Donald H. Burkett. My principal place of business is 3101 Sunset
3 Boulevard, West Columbia, South Carolina 29169.

4 **Q. WHAT IS YOUR CURRENT POSITION?**

5 A. I am employed as the Executive Vice President of Burkett Burkett & Burkett Certified
6 Public Accountants, P.A. where I have worked since 1976.

7 **Q. PLEASE STATE YOUR EDUCATIONAL AND PROFESSIONAL**
8 **BACKGROUND.**

9 A. I graduated in 1974 from the University of South Carolina with a Bachelor of Science
10 Degree in Accounting. I am a CPA licensed to practice accounting in South Carolina
11 and a member of the American Institute of Certified Public Accountants. From 1974
12 until 1976, I worked for a regional CPA firm before founding Burkett Burkett &
13 Burkett Certified Public Accountants, P.A. in 1976. I am a past President of the South
14 Carolina Association of Certified Public Accountants. I am a past Chairman of the
15 South Carolina Board of Accountancy, which regulates the licensure and practice of
16 accounting in the State of South Carolina. Most recently, I served as the Chair of the

1 National Association of State Boards of Accountancy. I have been involved with
2 auditing, tax return preparation, financial services, and advisory services for my entire
3 career for a variety of clients, including regulated utilities.

4 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

5 A. I have been retained by Kiawah Island Utility, Inc.'s ("KIU" or "Company") to prepare
6 the financial schedules submitted in connection with its application. The purpose of my
7 testimony is to support the application for an adjustment of certain rates and charges
8 for the provision of water and sewer services.

9 **Q. WHY IS KIU REQUESTING RATE RELIEF AT THIS TIME?**

10 A. With increased operating expenses and additional plant investments KIU has made
11 since its last rate case, KIU needs rate relief to provide safe, reliable, and high-quality
12 services to customers, be permitted an opportunity to earn a reasonable return on its
13 investment and attract capital for future improvements.

14 **Q. PLEASE DESCRIBE THE COMPANY'S APPLICATION.**

15 A. The Rate Case Application includes the financial statements for KIU. The subsections
16 are as follows:

- 17 • Schedule A - Balance Sheet
- 18 • Schedule B - Current and Pro Forma Income and Expense Statements
- 19 • Schedule C - Schedule of billed revenue at current and proposed rates, effect of
20 proposed rates and water and sewer assumption analysis
- 21 • Schedule D -Schedule of fixed assets and depreciation
- 22 • Schedule E - Schedule of present and projected customers

- Schedule F - Schedule of water and sewer proposed revenues
- Schedule G - Schedule of proposed rates

Also included in the Application are the most recent approval letters from the South Carolina Department of Health and Environmental Control, a sample customer bill form, and the Company's most recent Gross Receipts Tax Filing. The test year chosen is the year ended December 31, 2017, which was the twelve-month period of the Company's most recent fiscal year available at the time of the Company's filing.

Q. PLEASE SUMMARIZE THE PROPOSED CHANGES IN THE COMPANY'S RATE SCHEDULES.

A. Exhibit "A" to the Application contains the Company's Schedule of Proposed Water and Sewer Charges. A summary of the requested increase in base rates for the average residential or commercial customer with a 5/8" meter is shown below.

Residential & Commercial Base Rates			
<u>Class</u>	<u>Meter Size</u>	<u>Current</u>	<u>Requested</u>
Water	5/8"	\$34.29	\$37.71
Sewer	5/8"	\$26.20	\$28.81
Total		\$60.49	\$66.52

A summary of the requested increase in consumption rates for residential customers is shown below.

Residential Consumption Rates			
<u>Class</u>	<u>Up to</u>	<u>Current</u>	<u>Requested</u>
Water	11,000 gal	\$4.21	\$4.63
Sewer	11,000 gal	\$0.69	\$0.76
Total		\$4.90	\$5.39

A summary of the requested increase in consumption rates for commercial customers is shown below.

Commercial Consumption Rates			
<u>Class</u>	<u>Up to</u>	<u>Current</u>	<u>Requested</u>
Water	11,000 gal	\$5.03	\$5.53
Sewer	11,000 gal	\$2.68	\$2.95
Total		\$7.71	\$8.48

Q. PLEASE EXPLAIN HOW THE TEST YEAR COSTS WERE ADJUSTED.

A. Pro forma adjustments were made to the test year actual costs based on known and measurable changes to recorded costs.

Q. PLEASE DESCRIBE THE KNOWN AND MEASURABLE PRO FORMA ADJUSTMENTS MADE TO THE INCOME STATEMENT IN SCHEDULE B.

A. The major known and measurable pro forma adjustments made to the income statement in Schedule B are:

- Operating Revenue was adjusted to reflect the number of customers at year end using the rates that were effective as of October 25, 2018. This increased pro forma revenue by \$648,384.
- Payroll expenses were increased to reflect the known and measurable increases in effect for 2018 to both wages and benefits. This adjustment increased operation and maintenance expenses by \$327,840.
- The purchase water expense was increased to reflect increased costs passed on by KIU's supplier, the St. John's Water Company. This adjustment increased operation and maintenance expenses by \$136,024.

- 1 • Management fees were adjusted based on a three-factor overhead allocation and
2 to reflect a discretionary adjustment by Company management that results in a
3 net decrease to management fees of \$338,625.
- 4 • Property taxes were adjusted to reflect the second water supply main being
5 placed into service. The amount of the property tax adjustment is an increase of
6 \$237,829.
- 7 • Amortization expense was adjusted to reflect known and measurable
8 maintenance costs incurred in 2018 for sludge removal and tank painting.
9 These costs were amortized over three years and increase amortization expense
10 by \$68,078.
- 11 • Both federal and state income taxes were adjusted to reflect changes made in
12 tax rates by the Tax Cuts and Jobs Act, which reduced the federal income tax
13 rate to 21 percent. This adjustment reduced net income taxes by \$149,638.
- 14 • Rate Case expense was estimated at \$150,000 and amortized over three years.
15 Combined with previous rate case expense allowed, the net adjustment is an
16 increase of \$24,355.

17 **Q. HAVE KIU AND THE OFFICE OF REGULATORY STAFF ENTERED INTO**
18 **A MEMORANDUM OF UNDERSTANDING RELATED TO THE TAX CUTS**
19 **AND JOBS ACT?**

20 **A.** Yes, the Company and the Office of Regulatory Staff (“ORS”) entered into a
21 Memorandum of Understanding (“MOU”) in September 2018 to memorialize a
22 mutually acceptable understanding on how to treat the Tax Cut and Jobs Act (“TCJA”)

1 and related issues in this rate case. The MOU discusses the agreed upon treatment of
2 two specific issues: (1) the reduction in federal tax expense resulting from the change
3 in the federal income tax rate from 34% to 21%, and (2) excess deferred income taxes.
4 The MOU is included with this testimony as Exhibit DHB-1.

5 **Q. HOW HAS KIU ADDRESSED THE REDUCTION IN FEDERAL TAX**
6 **EXPENSE IN THIS CASE?**

7 A. The current 21% income tax rate has been included in the rate application for the
8 determination of the revenue requirement and new customer rates which will become
9 effective once approved by the Commission. Additionally, KIU has deferred tax
10 savings equal to the decrease in the federal income tax expense in a regulatory liability
11 account beginning January 1, 2018 and will continue until the date of the Commission
12 Order in this rate proceeding. KIU utilized its 2017 test year as adjusted for pro forma
13 items as the basis for calculating a regulatory liability. KIU intends to refund the final
14 regulatory liability to customers as credits on each monthly bill over a period no longer
15 than 36 months. The specific credit amounts per customer will differ based on meter
16 size. Once the regulatory liability has been refunded in full, KIU will cease providing
17 bill credits to customers. Based on the rate application as filed, KIU expects the total
18 refund to be approximately \$204,000.

19 **Q. HOW WILL EXCESS DEFERRED INCOME TAXES BE REFUNDED TO**
20 **CUSTOMERS?**

21 A. The TCJA required KIU to revalue accumulated deferred income taxes based on the
22 reduction in the federal income tax rate. This resulted in total Excess Deferred Income

1 Taxes ("EDIT") totaling \$733,925 which will be returned to ratepayers in accordance
2 with IRS normalization rules. IRS normalization rules require KIU to calculate the
3 refund of protected EDIT utilizing the Average Rate Assumption Method ("ARAM")
4 unless this is not possible. The Reverse South Georgia Method ("RSGM") should be
5 used if and only if utilizing ARAM is not possible. Any violation of the IRS
6 normalization rules could result in penalties which could include the loss of accelerated
7 depreciation for tax purposes and would be harmful to customers.

8 KIU completed a calculation and was able to utilize the ARAM method for the
9 years 2001 through the 2017 test year and followed the RSGM method for periods prior
10 to 2001. The resulting refund to customers will occur from the date new customer rates
11 are approved by the Commission through the year 2067. Annual refunds are higher in
12 the early years and decline over time. KIU proposes to amortize EDIT and reduce the
13 revenue requirement at an annual amount of \$38,640 which represents an average of
14 the first five years of the amortization period. In future rate cases, KIU will reduce the
15 amortization of EDIT included in determining customer rates to an extent that
16 customers are generally refunded in line with the calculated amortization schedule.
17 This will be done while ensuring that refunds occur no sooner than allowed under IRS
18 normalization rules.

19 **Q. WHAT COSTS ARE INCLUDED IN RATE CASE EXPENSES?**

20 A. Prudent rate case costs include attorney's fees, expert witness fees, capitalized time of
21 Company employees, and out-of-pocket expenses incurred in a rate case.

1 **Q. HOW DOES THE COMPANY PROPOSE TO SEEK RECOVERY OF**
2 **PRUDENT RATE CASE COSTS INCURRED SUBSEQUENT TO THE ORS’S**
3 **AUDIT CUT-OFF DATE?**

4 A. KIU will continue to update its rate case expenses after the ORS's audit cut-off deadline
5 and will provide the ORS with periodic updates. KIU will also file supplemental rate
6 case expenses with the Commission prior to the final hearing in this matter and will
7 seek to further update its expenses after its conclusion. KIU will ask the Commission
8 to allow recovery of the supplemented expenses.

9 **Q. WHAT RATEMAKING METHODOLOGY SHOULD THE COMMISSION**
10 **USE TO SET RATES IN THIS APPLICATION?**

11 A. The Company proposed that its rates continue to be determined using an operating
12 margin methodology. The application proposes an operating margin of 14.5%. The
13 application of the operating margin methodology in setting rates is a standard practice
14 well known to South Carolina regulators.

15 **Q. PLEASE EXPLAIN THE CHANGES IN THE NUMBER OF REPORTED**
16 **CONNECTIONS AND USAGE.**

17 A. In the calculation of operating revenue in its application, the Company drew the number
18 of connection counts by pipe size and usage from a different database than its billing
19 database. The number of connections is similar but allocated differently between
20 residential and commercial customers. This inconsistency was discovered upon audit
21 and reconciled. Due to this error, proforma revenue in the application was \$6,590
22 higher than it should have been.

1 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

2 A. Yes, it does.

EXHIBIT DHB-1

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2018-257-WS

Application of Kiawah Island Utility,
Incorporated for Adjustment of Rates,
Charges, Classifications and/or Regulations
for Water and Sewer Services

**MEMORANDUM
OF
UNDERSTANDING**

Whereas, the Tax Cuts and Jobs Act of 2017 Pub. L. 115-97 ("TCJA") changed the tax laws affecting utilities providing water and wastewater services, and

Whereas, Kiawah Island Utility, Inc. ("KIU") is a duly certificated public utility providing water and wastewater service to customers in South Carolina, and

Whereas, KIU gave notice of its intent to apply for adjustment of its rates and charges on August 3, 2018 prompting the Public Service Commission ("PSC") to open Docket 2018-257-WS in anticipation of the company filing its Application, and

Whereas, the Office of Regulatory Staff ("ORS") is the agency charged with representing the public interest in matters before the PSC, and

Whereas, the ORS desires to ensure that certain benefits of the TCJA inure to the benefit of the ratepayers, including customers of KIU, and

Whereas, several questions about the accounting treatment for the TCJA remain unresolved in Docket No. 2017-381-A, pending before the Commission, and

Whereas, KIU and ORS have reached a mutually acceptable understanding on how they desire to treat TCJA related issues in KIU's upcoming rate case, and

Whereas, KIU and ORS wish to memorialize their understanding and recommend its adoption to the Commission,

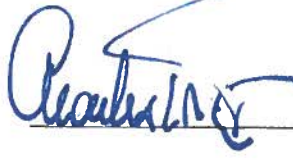
Now Therefore, KIU and ORS agree as follows:

1. Related to the revenues generated from the reduction in federal tax expense resulting from the change in the federal income tax rate from 34% to 21%:
 - a. KIU agrees to defer the tax savings in an amount equal to the decrease in federal income tax expense from 34% to 21% in a regulatory liability from January 1, 2018 through the date of the expected Commission Order in the next rate proceeding.
 - b. KIU and ORS agree the basis for the calculation of the regulatory liability is the test year period proposed by KIU in its expected Application (year ending 2017) as adjusted for pro forma adjustments.
 - c. ORS will review and audit the test year expense and revenue calculations contained in the Application and make necessary adjustments during the ORS evaluation of the KIU Application for rate adjustment. The pro forma expenses and revenue used would reflect all adjustments ordered by the Commission prior to adjustment for the rate increase allowed.
 - d. KIU and ORS will support the return of the tax savings booked to the regulatory liability to KIU customers by implementing a "Rate decrement", refund to customers as a credit on each monthly bill over a 36 month period.
2. Related to the Excess Deferred Income Tax re-valuation:

KIU will include in its upcoming Application a re-valuation of the Accumulated Deferred Income Taxes to Excess Deferred Income Taxes based on the reduction in federal income tax rate and consistent with IRS normalization rules. Both of these accounts are considered in the treatment of KIU's rate base. Excess Deferred Income Taxes will be amortized as a reduction to operating expenses using the weighted average depreciable life of the associated fixed assets.
3. KIU will cease to actively participate in Docket 2017-381-A upon entering into this Memorandum of Understanding.
4. KIU and ORS acknowledge this memorandum results from a compromise of dispute issues. Nothing in this memorandum will preclude either KIU or the ORS from asserting legal positions regarding the effects TCJA or any other issue in other proceedings.

Signed and agreed to on the date(s) below:

FOR KIAWAH ISLAND UTILITY, INC.:

 Date: 9/13, 2018

FOR THE OFFICE OF REGULATORY
STAFF:

 Date: 9/14, 2018